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## A STUDY IN THE DEVELOPMENT OF CREDITORS' RIGHTS.

### II.

We have seen that it is impossible by means of either execution or judgment creditor's bill to obtain equality of distribution, because both these methods of procedure rest entirely on the idea of priority. No creditor first on the ground can be compelled to relinquish his gain, and naturally he cannot be expected to do so of his own free will. Nor is there any method of procedure known to courts of equity by which the debtor can secure this result. True, there is the equity jurisdiction which is invoked by means of a "bill of peace" to prevent a multiplicity of suits; but obviously a debtor who confesses the justice of the claims against him cannot maintain such a suit.[1] That failing, no other equitable remedy can possibly suggest itself.

There is only one thing which a debtor can do of his own motion, but it is equally ineffectual. We refer to the general assignment. The courts of common law and the court of chancery recognized the right of a debtor to make a general assignment of his property to a third person in trust for the payment of his creditors, and while each creditor had an option of accepting the terms of this arrangement[2] there can be no doubt that all who accepted were bound by its provisions, and in turn the assignee and the debtor were also bound.[3] Such an arrangement was perfectly valid

[1]Weber *v.* Weber (1895) 90 Wis. 467; see generally Pomeroy, Equity (3rd ed.) § 250.

[2]Griffith *v.* Ricketts (1849) 7 Hare. 299; Tittle *v.* Vanleer (1896) 89 Tex. 174.

[3]Goodson *v.* Ellisson (1824) 3 Russ. 583; Brandenburg *v.* Thorndike (1885) 139 Mass. 102; Barcroft *v.* Lessieur (1871) 48 Mo. 418.

so far as the courts of common law and of equity were concerned; to use the language of Le Blanc, J.,[4] "a party, independently of the bankrupt statutes, may convey away his property for the benefit of all his creditors." But such an arrangement did not necessarily secure equality of distribution. The debtor did not always thus assign for purely altruistic reasons; more often he did it to lure his creditors away from their common law remedy. The debtor had the right in the very instrument itself to prefer such creditors as he pleased;[5] that, as we have seen, was his common law right, and why should he not exercise it even at the moment of offering to place his affairs in his creditors' hands? Also, the assignee had no status with regard to the debtor's affairs other than as derived from the deed of assignment. He could administer such property as passed to him by the deed, but nothing else. Consequently, if the debtor had previously transferred property in fraud of the very creditors for whose benefit the assignment of the remaining property was made, the assignee had no standing to sue for the recovery of the property which had been fraudulently conveyed. The short answer to his suit was, that he had never acquired any rights in this property because it had not been transferred to him; he was the trustee for the creditors' benefit, but only to the extent of the property he received.[6]

Certainly, therefore, we may say that in the case of a living debtor there is no voluntary proceeding on his part, and there is no process known to common law or equity, which will adequately secure an equal distribution of his assets among his creditors.

We say a *living* debtor because we are now brought to the other kind of creditor's bill, previously mentioned, which is the bill for general administration of the affairs of a decedent. Equity's long-established jurisdiction of this class of cases has been fully described in a notable book[7] from which the following summary is largely drawn.

Three causes contributed to the jurisdiction of equity in this class of cases: (1) the inadequacy of the courts having jurisdiction over probate matters; (2) the inadequacy of common law procedure for the protection of the executor; and (3) the harsh

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[4]Pickstock *v.* Lyster (1815) 3 M. & S. 371, 376.

[5]Pickstock *v.* Lyster, *supra.*

[6]Pryor *v.* Hill (1792) 4 Bro. Ch. 138; Wright *v.* Wigton (1877) 84 Pa. St. 163.

[7]Langdell, Brief Survey of Equity Jurisdiction (2nd ed.) 125 *et seq;* see also Jenks, Short History of English Law, 230-235.

rules of the common law affecting the succession of the creditors to the property of their deceased debtor.

The ordinary tribunals for handling the affairs of a deceased person were the ecclesiastical courts, but, as has been well said, "if the Church courts had ever afforded adequate process in such cases, the contempt into which they had fallen since the Reformation, and the increasing efficiency of the Common Law remedies, had virtually robbed them of their jurisdiction."[8] The ecclesiastical court preserved its jurisdiction to grant probate or letters of administration, but beyond that it could not go. It had no power to compel an accounting from the executor,[9] and on the other hand, the executor was not afforded the protection he needed in the administration of the decedent's affairs. For instance, there was no way for him to bar claims by any short notice, and if he depended on the ecclesiastical court, he would never know when he had the claims of all the creditors in his hands. In England, it was not until the present day that he was allowed to bar claims by advertising.[10] Nor were the common law courts equipped with the administrative powers sufficient for the convenience or protection of any parties in interest. If at any time the executor was sued on a debt owing by his testator, the court presumed that he had assets in his hands sufficient to pay the debt and put the burden upon him to show that he had none. On the other hand, the creditors were equally embarrassed in endeavoring to work out their rights by the medium of such a law court. The issue tried in a common law court as to whether assets were in the executor's hands did not

[8]Jenks, Short History, 226. As an instance of the contempt with which the court of chancery treated the ecclesiastical courts, see Backhouse *v.* Hunter (1787) 1 Cox Ch. 342. To such a point had these courts sunk that in the eighteenth century the proof of a will was not made by a certified copy furnished by the ecclesiastical court. Instead of that, the practice was to obtain from the chancery court an order compelling the prothonotary to give the will itself to the solicitor who desired it, upon his giving a bond to return it undefaced. Forder *v.* Wade (1793) 4 Bro. Ch. 476; Lake *v.* Causfield (1791) 3 Bro. Ch. 263.

[9]"The Court of King's Bench held (strangely enough) that the ecclesiastical courts had jurisdiction only to compel an executor to file *an* inventory,—not to compel him to file a sufficient and proper inventory; and hence, if one of those courts attempted to do the latter, the King's Bench would grant a prohibition, on the application of the executor. The creditor, therefore, could only obtain such an inventory as the executor chose to swear to and exhibit." Langdell, 139. This narrow range of the ecclesiastical court continued in England through all the statutory reformations, and even at the present day, as a result, the administration of decedents' estates is entirely in the hands of the Chancery Division. Maitland, Equity, 192.

[10]Stat. 22-23 Vict. c. 35; Maitland, Equity, 197.

admit of an accounting by which the executor would first exhibit a statement of his accounts and then be subject to examination thereon.

The executor, of course, handled only the decedent's personal property, but similar difficulties existed in the case of his real estate. In the hands of the heir, land was subject only to debts evidenced by instruments under seal or to such debts as the debtor's will specifically charged upon the land. In the case of a decedent who happened to own real estate, when most of his debts were not under seal, great injustice would thus result. It was to the interest of the simple-contract creditors, at least, that some method be devised by which all the testator's assets could be applied to the payment of his debts.

All of these difficulties resulted in the court of chancery taking jurisdiction over such cases.[13] Of course, a creditor always had the option to come in on his own behalf alone on the same basis as though his debtor were living and he had filed a judgment creditor's bill,[14] but if he did that, the executor would have the right to show that debts outranking his had been paid or were credited against the assets.[15] Hence, as a condition to securing the general administration of the estate, the plaintiff was considered as agreeing that all other creditors should be paid off on an equality with himself.[16] In that case, he came in, not for a decree against the executor for payment out of which the latter could recoup himself from the assets, but simply for a direction that the assets in the executor's hands be turned into court for equal distribution among the creditors.[17]

The court thus having established its jurisdiction, it became the universal practice to invoke it. And while the executor, as such, only administered the personal property of the testator, yet as the heir who succeeded to the real estate stood in practically the position of the executor, as succeeding to property which should be charged with the payment of debts, the practice was to join the heirs of the testator with the executor and thus bring into the

[13]The grounds of jurisdiction have been stated as: (1) the difficulties of an accounting, Langdell, 132-140; (2) to relieve against penalties, Langdell, 140-144; (3) to avoid a multiplicity of suits, Langdell, 148-152.

[14]Langdell, 169.

[15]Langdell, 168.

[16]Langdell, 169.

[17]Langdell, 170.

court both the land and the personal property for general distribution.[18]

Once the property was in court, the latter had full control over it and its distribution. The other creditors were not brought in as parties, but advertisement was made for them to prove their claims before the master and share in the distribution. The basis of the suit being equality, the court worked it out by means of the well-known doctrine of marshalling and subrogation, so that both the land and the personal property were applied to pay the testator's debts.[19] Of course, the court could not effect a system of equality entirely to its liking. Debts under seal outranked simple debts in England until Hinde Palmer's Act,[20] although a specialty debt without consideration was postponed;[21] and always personal property was considered as the primary fund for the payment of debts.[22] But compensation for these defects can be found in the fact that the court, having gathered a fund into its possession for administration, always felt itself empowered to secure the equal distribution it desired by means of enjoining the prosecution of any action against the executor which otherwise would result in a judgment giving priority to the particular plaintiff.[23]

Thus, in the eighteenth century, the situation was that whenever a man died leaving assets, whether real or personal, the court of chancery had jurisdiction to administer his affairs for the benefit of his creditors.[24] This jurisdiction passed to us as part of our inheritance, and we find frequent instances of its exercise,[25] but it has been gradually limited by the tendency of our States to increase the jurisdiction of their probate courts. In almost every

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[18] Langdell, 184.

[19] Langdell, 189.

[20] Stat. 32-33 Vict. c. 46; Maitland, Equity, 196.

[21] National Trust Co. *v.* Miller (1880) 33 N. J. Eq. 155; Maitland, Equity, 197.

[22] An idea that extends even to the laws of those States which allow the taxpayer, in order to ascertain the taxable basis of his personal property, to deduct from its market value the amount of his current indebtedness. People *v.* Board of Assessors of Albany (1869) 40 N. Y. 154, 162.

[23] Langdell, 173-177.

[24] "The Court of Chancery had, not merely acquired a share of administrative jurisdiction before the end of the seventeenth century, but had, by the end of the eighteenth century, practically secured the lion's share of that jurisdiction." Jenks, Short History, 229.

[25] *E. g.* Brown *v.* M'Donald (S. C. 1833) 1 Hill Eq. 297; Cleveland *v.* Chambliss (1879) 64 Ga. 352.

American commonwealth, the probate court of today not only has jurisdiction to grant probate of wills and letters of administration, but to receive and pass upon the accounts of executors, distribute the assets in their hands, and discharge them from their trusts. There still remain, of course, various limitations; even today the legislature of New York seems unwilling to grant the surrogate's court the full powers of the court of chancery,[26]—but in so far as the particular probate court of a State may have jurisdiction, the State's chancery courts are apt to refuse to exercise the jurisdiction which they once possessed.[27]

A curious survival of the ancient jurisdiction, however, may be found in the practice of the federal courts. As is well known, these courts took over the powers exercised at the time of our separation by the English court of chancery, and their prerogatives, as they have always considered, can in no case be defeated by subsequent state statutes giving equivalent remedies to common law or probate courts of the State in which the suit may arise.[28] It follows that once the probate court has issued letters of administration, then the federal courts have co-ordinate jurisdiction over matters of accounting with the probate court.[29] Whether they have jurisdiction to set aside the probate of a will once granted is still a matter of some doubt,[30] but it seems clear that, pending the probate of the will or issuance of letters, the federal courts may properly appoint a receiver of the decedent's affairs.[31] Of course, this jurisdiction is not exclusive, but is only concurrent with that of the probate court, and hence will be defeated by any prior decision of that court to which the present plaintiff was a party.[32]

However limited the jurisdiction of equity in this country may

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[26]See *In re* Brown (N. Y. 1913) 79 Misc. 675.

[27]Rutherford *v.* Alyea (1896) 54 N. J. Eq. 411.

[28]McMullen Lumber Co. *v.* Strother (C. C. A. 1905) 136 Fed. 295.

[29]Payne *v.* Hook (1868) 7 Wall. 425; Waterman *v.* Bank (1909) 215 U. S. 33; Pulliam *v.* Pulliam (C. C. 1879) 10 Fed. 23; Lecouturier *v.* Ickelheimer (D. C. 1913) 205 Fed. 682. A jurisdiction which "cannot be defeated or impaired by laws of a State undertaking to give exclusive jurisdiction to its own courts." Lawrence *v.* Nelson (1892) 143 U. S. 215.

[30]See *In re* Broderick's Will (1874) 21 Wall. 503; McDermott *v.* Hannon (D. C. 1913) 203 Fed. 1015.

[31]Underground Electric Rys. *v.* Owsley (C. C. A. 1909) 176 Fed. 26.

[32]Johnson *v.* Waters (1884) 111 U. S. 640; Arrowsmith *v.* Gleason (1889) 129 U. S. 86. The recent case of McCauley *v.* McCauley (D. C. 1913) 202 Fed. 280, where the court refused to take jurisdiction because accounting proceedings were already pending in the state court, would seem wholly wrong.

thus be in the case of a decedent's estate, the matter is of particular interest at this point, because from it, as we believe, has come the present powers of courts of equity to administer the affairs of an insolvent corporation. Speaking broadly, it is suggested as the reason why the chancery court habitually administered the property of a deceased debtor, that the decedent's property had been left in the air, by his death, without adequate protection. So long as a decedent lived, he could handle his own affairs, and the let-alone instinct of the common law, illustrated by its encouragement of the race of diligence to which we have referred, left the property in the care of the man who owned it. If he did not pay his creditors, that was a matter for them to work out by means of the ordinary process for the collection of debts. But when he died the property passed into the hands of the executor, or if real estate, of his heir, who received it charged with at least a moral duty of first paying the debts attributable to it; this duty, of necessity, being limited to the assets in his hands. This, of course, was not a trust. No one ever claimed that an executor or heir was in the position of a trustee, nor is that at all the question. The focal point, it is suggested, is that the court saw before it a fund dedicated to the one purpose of immediate administration. It took jurisdiction simply for the purpose of administration, because no other court could do it, and because without the aid of the court the person charged with the administration could not adequately perform his duty.[33]

In this country it is a principle of almost universal sway that the assets of an insolvent corporation are a trust fund for the payment of its debts. It is not the present purpose to go into a general discussion of this hackneyed theme. While the doctrine, taking it by and large, fails of justification in sound reason, yet to a certain extent it has a sound basis, and that appears when the theory is considered from the standpoint of administration. The estate of an insolvent corporation is like that of a decedent in one fundamental aspect. Of course mere insolvency does not end the corporate life; a chancery winding-up does not have that effect;[34] nor does even bankruptcy take away the company's charter exist-

[33]This suggestion is made with great diffidence, as it is not directly supported by any of the eminent writers already quoted, but it seems to come within the spirit of their respective expositions.

[34]Bank of Bethel *v.* Bank (1871) 14 Wall. 383, 400; Continental Securities Co. *v.* Interborough R. T. Co. (C. C. 1908) 165 Fed. 945; Detroit, etc. Ry. *v.* Campbell (1905) 140 Mich. 384.

ence.[35] But that does not affect the really important feature of resemblance, that in each case there is present a limited fund dedicated to the primary purpose of distribution among creditors. The stockholders and directors are not personally liable to the company's creditors; the latter can look only to the corporate funds for payment. Whenever you have such a case, there you have a jurisdiction which may be invoked by the bill of any creditor who chooses to ask the court, on behalf of himself and all the other creditors equally, to gather in and distribute the corporate assets on the basis of equality and by the use, if need be, of the equitable doctrines of marshalling. Such a bill, to use the words of the Supreme Court, is "quite sufficient to enable a court of equity to administer the property and marshal the debts."[36]

If we take it simply from this standpoint of administration, rather than entangle ourselves in the reasoning attendant upon viewing it as a rule of substantive law, the trust fund doctrine, while narrowed in scope, acquires much more of a logical outline. The Supreme Court evidently meant to give the doctrine but little if any wider range when it described the "trust" in the case of an insolvent corporation as "rather a trust in the administration of the assets after possession by a court of equity than a trust attaching to the property, as such, for the direct benefit of either creditor or stockholder."[37] At any rate, this point of view is sufficient to justify this equity jurisdiction, as resting entirely upon the existence of a limited fund for purposes of distribution among creditors.[38]

This is illustrated by two notable cases. In *Case* v. *Beauregard*[39] it was held that there is nothing in the nature of a partnership to give the creditors an equity in the firm property so as to

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[35] *In re* Jacobson & Son Co. (C. C. A. 1912) 196 Fed. 949; Coburn *v.* Boston Paper Co. (Mass. 1857) 10 Gray, 243; Wood & Selick *v.* Vanderveer (N. Y. 1900) 55 App. Div. 549.

[36] Union Trust Co. *v.* Illinois Midland Ry. (1885) 117 U. S. 434, 459.

[37] Hollins *v.* Brierfield Coal Co. (1893) 150 U. S. 371, 383.

[38] Recently Noyes, J., has described "the evolution of the creditor's bill into the proceeding by which courts of equity undertake the general administration of the estates of corporations" as springing from the judgment creditor's bill. Penn Steel Co. *v.* N. Y. C. Ry. (C. C. A. 1912) 198 Fed. 721, 737. It is submitted that if this jurisdiction had started with that, it would never have gotten a real start, because, as we have seen, the idea of priority is inseparable from the conception of the judgment creditor's bill. Some courts may have required a judgment as proof of the debt, in the present class of cases, but they did not take jurisdiction to enforce the judgment.

[39] (1878) 99 U. S. 119.

enable them to follow it into the hands of third persons by means of a bill in chancery; the court saying:

"It is indispensable, however, to such relief, when the creditors are, as in the present case, simple-contract creditors, that the partnership property should be within the control of the court, and in the course of administration, brought there by the bankruptcy of the firm, or by an assignment, or by the creation of a trust in some mode. This is because neither the partners nor the joint creditors have any specific lien, nor is there any trust that can be enforced until the property has passed *in custodiam legis*. Otherwise the property can be followed only after a judgment at law has been obtained and an execution has proved fruitless."[40]

On the other hand, when the New York legislature provided for special partnerships, that is, partnerships where the liability of one partner is limited to the amount which he puts into the firm, Chancellor Walworth held that upon such a concern becoming insolvent, its assets became impressed with a trust for the benefit of its creditors, and the court on the application of any creditor should wind up the affairs of the firm for the benefit of all.[41] The Chancellor said:

"I regret that I am obliged to extend the jurisdiction of this court to this new class of cases. But whenever the legislature creates new rights in parties, for the protection and enforcement of which rights the common law affords no remedy, and the statute itself does not prescribe the mode in which such rights are to be protected, this court, in the exercise of its acknowledged jurisdiction, is bound to give to a party the relief to which he is equitably entitled under the statute."[42]

There we have the entire idea. So long as no artificial limits are placed upon the responsiveness of the debtor to the demands of his creditors, there is no room for equity jurisdiction. The fact that he is insolvent, while in effect limiting his ability to pay all his debts in full, never was considered as a sufficient reason for equity taking up the general administration of the debtor's affairs. So with an insolvent partnership, since a partnership has never been more than a mere association of persons whose liability for debts is unlimited. But it is quite a different thing when the State sanctions any association, whether corporation or limited partnership, which at best does business with but a limited fund beyond which no

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[40]The same result was reached years ago by Lord Eldon in *Ex parte* Ruffin (1801) 6 Ves. 119.

[41]Innes *v.* Lansing (N. Y. 1839) 7 Paige, 583.

[42]Innes *v.* Lansing (N. Y. 1839) 7 Paige, 583, 586; see also Whitcomb *v.* Fowle (N. Y. 1879) 7 Abbott N. C. 295.

creditor can reach. So long as this fund is adequate for the payment of debts, there is no need to consider any special administrative powers of equity, because by means of execution or judgment creditor's bill, each creditor can come into his own.[43] But when those assets become insufficient to meet the liabilities, then the administrative jurisdiction of an equity court may be invoked by any creditor for the benefit of all.

Under the vast jurisdiction which has thus arisen, the affairs of thousands of corporations have been administered, and there has been created in this country a body of "receivership" law whose size would astonish an English practitioner. For this branch of equity jurisdiction is peculiarly American. In England the increase in use of the corporate form of conducting business brought with it the admirable winding-up provisions of the Companies Acts, so that it was never necessary for the English chancery court to work out its own jurisdiction in such cases.[44]

In this connection, several distinctions should be observed. For instance, the bill cannot pray a dissolution of the corporation in the sense that its charter life shall be ended. In many States at the present day,[45] jurisdiction has been conferred upon courts of equity to entertain proceedings by the creditors of an insolvent corporation for the double purpose of distributing its assets and

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[43]Carson *v.* Allegany Glass Co. (C. C. 1911) 189 Fed. 791. The Supreme Court has frequently declared that the "trust" does not attach to the assets of a solvent corporation. See McDonald *v.* Williams (1899) 174 U. S. 397.

[44]Evans *v.* Coventry (1854) 5 DeG. M. & G. *911, though often cited in support of the trust fund theory, seems to have no application. The plaintiff held a policy in a life insurance company, and relief was granted on the theory that his policy gave him an equitable charge on the company's funds. A similar case was Towle *v.* American Bldg. & Loan Soc. (C. C. 1894) 60 Fed. 131; but neither case has any real bearing on the point of interest to us. In two instances English judges have used this theory very ingeniously in order to avoid the strict English doctrine of *ultra vires*. *In re* Guardian Bldg. Soc. (1882) L. R. 23 Ch. Div. 440; *In re* Birkbeck Bldg. Soc. (1912) 28 Times L. R. 451; see also 57 Sol. Journ. 167. But as we have said, it was never necessary for the English courts to go further than this. A bill for such a purpose was once filed, it is true, but the court denied its power to wind up the affairs of a public service company. Gardner *v.* London, etc. Ry. (1867) L. R. 2 Ch. App. 201, 212. This jurisdiction is well established with us on creditor's bill. Union Trust Co. *v.* Illinois Midland Ry. (1885) 117 U. S. 434, 458; American Brake Co. *v.* Pere Marquette Ry. (C. C. A. 1913) 205 Fed. 14. "The practice * * * has become particularly well established in the case of quasi-public corporations where the interests of the public require continuous and continued operation, and where, generally, the bankrupt act is not available." Noyes, J., Penn. Steel Co. *v.* N. Y. C. Ry. (C. C. A. 1912) 198 Fed. 721, 737, n. 9.

[45]*E. g.* New Jersey Corporation Law, § 65, and New York General Corporation Law, §§ 101-102.

ending its corporate existence.[46] But in the absence of such statute, no court of equity has such power. And such instances must be carefully distinguished from the jurisdiction of the court in the cases of which we speak. No statute authorizes a bill of the present kind, and no statute governs the procedure. True, the courts in matters of administration on such a bill follow as nearly as possible the practice in bankruptcy as a safe and convenient guide,[47] but it has never been suggested that they are compelled to do so.

Another distinction occurs in this connection. A bill of the character now under consideration is essentially different from the ordinary kind of judgment creditor's bill.[48] The fact that a corporation is insolvent does not deprive the creditor of the right to file a judgment creditor's bill and make the same claim of priority that he could in the case of any other insolvent debtor. The creditor has the option to file either the one bill or the other. As the Supreme Court has said:[49] "It was his privilege, under the law, to sue for his own benefit, and it was within the power of the court, for his protection as a judgment creditor, to place the property of the debtor company in the hands of a receiver, for administration under its orders." But the creditor must make his choice at the outset. If he files a bill for general administration, he has no claim of priority. Once he has made his decision, he must abide by it; and the nature of his choice must be gathered from the allegations of his bill. The question then is whether the plaintiff chose to come into court for a general administration of the corporation's affairs for the benefit of all the creditors equally with himself, or whether he chose as a judgment creditor to ask nothing but the application of such assets as could be found to the payment of his own claim.[50]

It is perfectly proper for this jurisdiction to be invoked by "collusion." If the corporation is insolvent, for its own protection it can lawfully procure a friendly creditor to file a bill against it,[51]

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[46]The federal courts have held that the presence of such a state statute confers upon them the same jurisdiction. Land Title & Trust Co. *v.* Asphalt Co. (C. C. A. 1903) 127 Fed. 1; Jacobs *v.* Mexican Sugar Co. (C. C. 1904) 130 Fed. 589.

[47]Conklin *v.* U. S. Shipbuilding Co. (C. C. 1905) 136 Fed. 1006.

[48]Prof. Langdell draws this distinction at the outset of his discussion. Langdell, 125 n.

[49]Sage *v.* Memphis etc. Ry. (1888) 125 U. S. 361, 376.

[50]Haehnlen *v.* Drayton (C. C. A. 1911) 192 Fed. 300.

[51]Sage *v.* Memphis etc. Ry. (1888) 125 U. S. 361; Hollins *v.* Brierfield Coal Co. (1893) 150 U. S. 371; *Re* Metropolitan Ry. Receivership (1908) 208 U. S. 90. So could an executor procure the filing of a bill by a friendly creditor. Langdell, 171.

and there is nothing objectionable in this sort of collusion. If the debt is really owing to the plaintiff as he alleges, it is right for the defendant to admit it; this admission cannot deprive the court of jurisdiction, otherwise no court could ever enter a decree *pro confesso*; and finally, the motive which induces the plaintiff to file his bill in one court rather than another, or to file his bill at all, is entirely immaterial.[52] This reasoning, in which all courts seem to concur, has not been without its consequences. The fact that one hand guides both bill and answer led at an early date to the practice, where no creditor had yet secured a judgment, of letting a simple-contract creditor file the bill. Any possible objection, it is held, is waived by the general answer of the corporation which always accompanies the bill to the files of the court.[53]

As a result, such a bill is almost invariably filed by a friendly creditor, the corporation puts in an answer admitting its allegations, and thereupon a receiver is appointed to take charge of the defendant's assets. Thenceforward the suit proceeds toward the goal of final distribution, and this is its only terminus, unless meanwhile, by means of some reorganization arrangement to which the creditors consent, the bill is dismissed and the receivership terminated.

This practice, as might have been expected, has led to some strange misconceptions regarding the nature of a "receivership case." It is all very well for a leading text-book to speak of "friendly receiverships" as an institution with us,[54] but the vulgar error[55] that the courts will allow a receivership for any other purpose than a winding-up, should never be tolerated. There is no such thing as a nursing receivership. Long ago Lord Eldon pointed out, in the case of a partnership dispute, that a court of chancery had no right to appoint a receiver simply to enable the parties to adjust their affairs.[56] No more has a court of chancery today the power to appoint a receiver merely to enable a corporation to tide over its difficulties,[57] or to enable its creditors and

[52]The Supreme Court thus sums up the reasoning of the earlier cases. *Re* Metropolitan Ry. Receivership (1908) 208 U. S. 90.

[53]Sage *v.* Memphis etc. Ry. (1888) 125 U. S. 361; Horn *v.* Pere Marquette Ry. (C. C. 1907) 151 Fed. 626.

[54]Alderson, Receivers, 5.

[55]An error which sometimes creeps even into judicial opinions. See Schumert & Warfield *v.* Brewing Co. (D. C. 1912) 199 Fed. 358.

[56]Waters *v.* Taylor (1807) 15 Ves. 10.

[57]Duncan *v.* Treadwell Co. (N. Y. 1894) 82 Hun, 376.

bondholders to effect a plan of reorganization.[58] If the record or the conduct of the parties shows that the object was any other than liquidation, the court will refuse jurisdiction; if the liquidation is unduly delayed, the court will divest itself of jurisdiction so as to let in the other creditors according to their common law priorities.[59] Emphatic language has been used on this point many times. "We are not aware," says the New York court, "of any statute or law which justifies the continuance of the receivership for the purpose of giving the corporation time to raise money to pay its debts."[60] As our highest tribunal has said, "a court is a very unsatisfactory body to administer the affairs of a railroad as a going concern, and * * * the possession of such property by the court through its receivers should not be unnecessarily prolonged."[61]

This is perfectly consistent with the encouragement the courts give the creditors to combine their interests by means of a reorganization committee,[62] and their view that it is proper for the

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[58]Gutterson & Gould *v.* Lebanon Steel Co. (C. C. 1907) 151 Fed. 72; Burton *v.* Peters Salt Co. (C. C. 1911) 190 Fed. 262.

[59]East Tenn. etc. R. R. *v.* Atlantic R. R. (C. C. 1892) 49 Fed. 608; Merchants' & Planters' Nat. Bank *v.* Trustees (1879) 63 Ga. 549; Wilmer *v.* Railroad Co. (C. C. 1875) 2 Woods, 409; Schloss *v.* Schloss (N. Y. 1897) 14 App. Div. 333; Mercantile Trust Co. *v.* Baltimore etc. R. R. (C. C. 1898) 89 Fed. 606. Even the jurisdiction of a bankruptcy court can be defeated in this way. Acme Harvester Co. *v.* Beekman (1911) 222 U. S. 300. In one case the receiver, because of his co-operation in such a purpose, was deprived of his compensation. Campau *v.* Driving Club (1906) 144 Mich. 80.

[60]Duncan *v.* Treadwell Co. (N. Y. 1894) 82 Hun, 376, 377. In Gardner *v.* London etc. Ry. (1867) L. R. 2 Ch. App. 201, 212, Cairns, L. J., said:

"Now I apprehend that nothing is better settled than that this court does not assume the management of a business or undertaking except with a view to the winding up and sale of the business or undertaking. The management is an *interim* management; its necessity and its justification spring out of the jurisdiction to liquidate and to sell; the business or undertaking is managed and continued in order that it may be sold as a going concern, and with the sale the management ends."

In *In re* Receivers Philadelphia etc. R. R. (C. C. 1881) 14 Phila. 501-502, Butler, J., said:

"The modern practice prevailing to some extent, elsewhere, of transferring corporate property to the custody of the courts, to be thus held and managed for an indefinite period of years, to suit the convenience of the parties, whereby general creditors and stockholders are kept at bay, I regard as a mischievous innovation."

"In this class of cases, if it later develops that the receivership is being managed with a view to primary operation and contingent liquidation rather than primary liquidation and incidental operation, the remedy is not to conclude that there was no jurisdiction to appoint the receiver, but to direct the receiver to perform his duty." Burton *v.* Peters Salt Co. (C. C. 1911) 190 Fed. 262, 265.

[61]*Re* Metropolitan Ry. Receivership (1907) 208 U. S. 90, 111.

[62]Continental etc. Trust Co. *v.* Allis-Chalmers Co. (D. C. 1912) 200 Fed. 600.

receiver, so far as consistently may be, to co-ordinate his efforts with those of the committee.[63] That is merely by the way; of course, the creditors should be allowed to save expense by withdrawing the assets from court if they can all agree on a good way of doing it. But that is quite a different thing from saying that the court takes jurisdiction for any such purpose. The court takes jurisdiction only to liquidate, and liquidate it will unless meanwhile the assets are withdrawn by the consent of all in interest.

The system of judicial administration thus created is perfect as far as it goes, and it goes as far as it possibly may. But it has its limitations.

So far as concerns property in the debtor's possession, the creditors' rights are clear. The court, of course, has the power to limit the time for claims to be filed with the receiver or a master appointed for such purpose,[64] and, after a final distribution has been made, will protect its distributing officers against the attacks of belated creditors.[65] The creditors who are thus duly in court are entitled to a distribution of the assets in hand on a basis of absolute equality, land and goods going as one; but of course prior liens must be duly respected. A creditor is only entitled to what his debtor has, and if the debtor's property has been saddled with a valid lien, the creditor can only realize on the debtor's equity of redemption.

The party holding such a prior lien may do one of two things. If he desires to realize on his lien while the receivership lasts, he must come into the equity court for leave to proceed; because to do otherwise would result in an intolerable interference with the receiver's possession.[66] But if the lienor chooses to stay out, resting upon his lien, he cannot be compelled to come in. The court must administer the property subject to the lien, and it can be enforced, after the closing of the receivership, against anyone who may have purchased the charged property on the liquidation sale. That has frequently been held in the case of judgment creditors'

[63]Clarke *v.* Central R. R. (C. C. 1893) 66 Fed. 16; Fowler *v.* Jarvis-Conklin Co. (C. C. 1894) 63 Fed. 888.

[64]Smith *v.* Jones Lumber Co. (D. C. 1912) 200 Fed. 647.

[65]Farrell *v.* Smith (1813) 2 B. & B. 337; Halsted *v.* Forest Hill Co. (C. C. 1901) 109 Fed. 820; Woodruff *v.* Jewett (1889) 115 N. Y. 267; Walsh *v.* Raymond (1889) 58 Conn. 251; Keene *v.* Gaehle (1881) 56 Md. 343.

[66]*In re* Tyler (1893) 149 U. S. 164; Wiswall *v.* Sampson (1852) 14 How. 52; Wabash R. R. Co. *v.* Adelbert College (1908) 208 U. S. 38.

bills, and the same principle must apply to the present form of procedure.[67]

A winding-up of this kind is therefore of little avail if the filing of the bill is too long delayed; because, once the race of diligence starts, the successful judgment creditors may secure liens which the chancery court perforce must recognize. Indeed, it is a familiar allegation in bills of this sort that certain of the creditors have already entered suit against the corporation and others are about to do so, all of which, if left alone, will result in preferences to one or the other which the court must then recognize to the injury of the other creditors. The only thing that can cut short this race is for the court to take jurisdiction over the debtor's affairs and appoint a receiver as an interim measure.

Of course the appointment of the receiver does not of itself stay the suits pending against the debtor, nor is it good practice for the court to enjoin their further prosecution. In one form or another the creditor must finally liquidate his claim, as the court must receive it whenever it is liquidated so long as that process is completed prior to the decree settling the list of distributees.[68] If the creditor chooses to liquidate his claim by plenary suit rather than before the master appointed to make up the list of distributees, that is a right with which the equity court is not inclined to interfere.[69] Apart from all questions of jurisdiction[70] the chancery court should not enjoin the prosecution of such an action to judgment.[71]

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[67]Chatauque County Bank *v.* Risley (1859) 19 N. Y. 369; Hillyer *v.* LeRoy (1904) 179 N. Y. 369; Jackson *v.* Holbrook (1887) 36 Minn. 494. As has been said: "A debtor's conveyance of his real estate to a receiver, although it may be compulsory, is in its nature simply and purely the creation of a trust for the payment of the debts on which the proceedings in equity are founded. * * * But no creditor having a statutory lien by judgment can be compelled to take the equitable remedy. He may, if he prefer, stand upon his lien and the means which the law has given him of enforcing it." Chatauque County Bank *v.* Risley (1859) 19 N. Y. 369, 374-375.

[68]N. Y. Security & Trust Co. *v.* Lombard (C. C. 1896) 73 Fed. 537; Penn. Steel Co. *v.* N. Y. City Ry. (C. C. A. 1912) 198 Fed. 721.

[69]Honegger *v.* Wettstein (1883) 94 N. Y. 252; Wilder *v.* New Orleans (C. C. A. 1898) 87 Fed. 843.

[70]For example, the federal courts are broadly forbidden by statute from enjoining the maintenance of a suit in a state court. See Nelsen *v.* Camp (C. C. A. 1911) 191 Fed. 712.

[71]Mercantile Trust Co. *v.* Pittsburg R. R. (C. C. 1887) 29 Fed. 732; Earle *v.* Conway (1900) 178 U. S. 456.

But when the creditor, thus left alone, enters up his judgment, his freedom of action ends. He will not be allowed to avail himself of any remedies under that judgment which would make for inequality, or, to put it from the more familiar point of view, interfere with the receiver's possession of the debtor's assets. The only thing the creditor is allowed to do with his judgment is to prove it as a claim before the master.[72]

Thus, so far as property on hand is concerned, equality of distribution is assured. The same result is achieved with respect to property which is not on hand but which is owned by the debtor. The chancery court through its receiver can summarily gather in all concealed, lost, or "forgotten" property. No one can withhold property from the receiver's possession unless under a colorable claim of right. If a colorable claim is made, then the receiver must proceed against the plaintiff by plenary suit, but in all other cases the court has the power summarily to take the property away from the claimant and give it into the receiver's possession.[73]

We have now made the circuit of this winding-up jurisdiction which the equity courts have created. But in doing this we have not discovered a complete system for effecting equality of distribution. Firstly, not all cases are embraced within it. The estates of decedents and the estates of corporations and limited partnerships are thus covered, but there are living debtors to be reckoned with, and common law partnerships. And even when we have a case within these bounds, we find the court lacking power in a most serious respect. The receiver must fairly distribute the property in his possession; he can defend his right of possession and he can gather all the available assets into his possession. But the court's powers fail when it comes to the case of any of the wrongs which

[72]Tracy *v.* The Bank (1868) 37 N. Y. 523; Mercantile Trust Co. *v.* Pittsburg R. R. (C. C. 1887) 29 Fed. 732; Wilder *v.* New Orleans (C. C. A. 1898) 87 Fed. 843. It must be remembered that the appointment of a receiver on a bill of this sort takes all the property of the company into the exclusive cognizance of the court which appoints the receiver. The appointment of the receiver relates back from the filing of his bond to the date of his appointment "and actual seizure by him is not necessary to cut off rights which attach only after the order of appointment." Horn *v.* Pere Marquette Ry. (C. C. 1907) 151 Fed. 626.

[73]Horn *v.* Pere Marquette Ry. (C. C. 1907) 151 Fed. 626; Underground Electric Rys. *v.* Owsley (C. C. A. 1909) 176 Fed. 26; Wheaton *v.* Daily Telegraph (C. C. A. 1903) 124 Fed. 61; Dexter Horton Nat. Bank *v.* Hawkins (C. C. A. 1911) 190 Fed. 924. This point is of most value in averting conflicts between the federal and the state courts. Where the two actions pend in the same court, and that court has jurisdiction of both law and equity, this rule of comity is unnecessary, as it presents then only "a question of administration of assets." Cass *v.* Sutherland (1898) 98 Wis. 551.

the debtor may have inflicted upon the creditors prior to the filing of the bill. If the debtor has fraudulently conveyed or encumbered any part of the property, or used it to prefer one creditor over the other, can the wrong thus inflicted be redressed by this method of procedure?

This question can only be answered with another. In order that the property thus fraudulently treated may be made available for equal distribution among the creditors, it must be brought into the estate already in the hands of the equity court. Somebody must bring a suit for that purpose, as the representative of the court, or, if one pleases to have it so, as the representative of all the creditors. The court therefore must appoint such a representative, and the receiver would naturally be chosen. So the question is, can the chancery court clothe its receiver with such powers?

On principle, this question must be answered in the negative. The Statute of Fraudulent Conveyances never was intended as anything but an aid to the enforcement of a judgment already obtained. The doctrine of reputed ownership, which started with a bankruptcy statute in England and with us rests upon a principle of estoppel, must in logic take the same course, because, as we have seen in the first installment, it is not until the creditor secures judgment that he is entitled to complain of the debtor's conduct respecting his property. Of preferences we shall speak presently; for the moment let us confine ourselves to cases of fraudulent conveyance and reputed ownership, for whose redress, be it repeated, the creditor must first have obtained a judgment. As we have seen, the right of priority is inseparable from the judgment; to assert one is to maintain the other, and one cannot be abandoned without the other. The receiver, of course, takes no title to the assets in his charge, and even if he should, his title would come from the corporation, which cannot itself repudiate its own acts. Nor are we helped by assuming that the receiver represents the creditors rather than the debtor, because the essence of this winding-up jurisdiction is that these creditors do not occupy the position of judgment creditors but have waived all rights of priority based thereon, and, as simple-contract creditors without liens, are the beneficiaries of a fund in court. For the court to empower its officers to set aside a fraudulent transaction is to impeach its jurisdiction, because the officer, in order to bring such an action, must represent persons who have not abandoned the right to attack the fraudulent transaction; in other words, persons who still insist upon

their priorities. This point is strongly made by the Supreme Court in *Myer* v. *Car Co.*[74] There a receiver appointed in a foreclosure action, instituted upon a mortgage which covered all of the property of a railroad company, attempted to set aside a contract of conditional sale under which certain equipment had been delivered, upon the ground that the contract had not been recorded as provided by the laws of the State where the delivery occurred. The recording act of that State provided that such agreements, when unrecorded, should be void as against the creditors of the vendee. The court, assuming for the purpose of argument that the receiver represented the creditors,[75] held that he could not attack the transaction because the recording act should be construed in the same way as the Statute of Fraudulent Conveyances, and that the rule with respect to that statute was clear:

"Until suit was commenced, the parties were at liberty to deal as they pleased with the property conveyed, and the rights of creditors were determined by the condition in which the property was when they interfered. * * * The rights of the parties were fixed at the moment the property was taken by the court through its receiver into its own possession. At that time these appellants were not either execution or attaching creditors."[76]

Precedents lead us to the same result. The uniform practice in the case of a decedent's estate negatives the idea that a receiver can be clothed with any such power. In spite of the fact that the decedent's affairs had been taken into administration on a winding-up bill, no creditor who discovered that the decedent had fraudulently transferred or encumbered property thought of asking the equity court to use its receiver for the purpose of setting the transaction aside. Nor, on the contrary, was it ever considered that the death of the debtor or the pendency of the winding-up bill barred any diligent creditor from filing a judgment creditor's bill to set aside the fraudulent transaction, and secure the same priority therein that he would have secured had the debtor still been living. The only point that ever arose in this connection was whether it was necessary for the creditor to go through the form of obtaining a judgment against the executor as a prerequisite to filing his judgment creditor's bill. This point, however, occasioned little diffi-

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[74](1880) 102 U. S. 1.

[75]"Every mortgagee is necessarily a creditor. A mortgage is in general but an incident to the debt it secures, and the mortgagee is nothing more than a creditor secured by mortgage."

[76]Myer *v.* Car Co. (1880) 102 U. S. 1, 12; Fosdick *v.* Schall (1878) 99 U. S. 235.

culty. In *Cleveland* v. *Chambliss*[77] it was held that it was not necessary for the creditor to show a judgment, where he had been enjoined from bringing an action by the same court during the pendency of the administration bill. In like manner it was held that the filing of a proof of claim is sufficient to excuse the absence of a judgment, whether it is filed with the executor,[78] or with the master who had been appointed in the administration suit to receive the creditors' claims.[79] If the creditors, said the New Jersey court, "had exhausted their remedy at law against the estate of which he died seized and possessed, this court should be open to them to enable them to reach if necessary for the satisfaction of their debts, any property which in fraud of their rights, he may have placed in the hands of others."[80]

Doubtless many books and opinions affirm the right of a chancery receiver, as the representative of the creditors, to maintain suits to set aside fraudulent transactions. But the cases commonly cited for such a view have been properly classified as cases[81] "where the receiver by force of some statute can act for creditors; where the act complained of was *ultra vires* and not binding upon the corporation; where the receiver was appointed in a proceeding prosecuted by the creditors which was supplemental to execution, and the receiver had the rights of the creditors at whose instance and to secure whose claims he was appointed; and where the receiver was suing for property or assets that belonged to the debtor." Of course, a receiver may sue to recover property belonging to the corporation but withheld from him, but he must sue in the debtor's name,[82] and is bound by all the defences available against the debtor.[83] Of course, he can sue in his own name to protect his own right of possession, or to redress injuries to the property in his charge,[84] and that is all that the broad language in *Davis* v. *Gray*[85] really means. And of course if a statute authorizes him to sue to set aside a fraudulent transaction he may do so, but the very

[77](1879) 64 Ga. 352.

[78]Haston *v.* Castner (1878) 29 N. J. Eq. 536; Hills *v.* Sherwood (1874) 48 Cal. 386.

[79]Brown *v.* M'Donald (S. C. 1833) 1 Hill Eq. 297.

[80]Haston *v.* Castner (1878) 29 N. J. Eq. 536, 537.

[81]Republic Life Ins. Co. *v.* Swigert (1890) 135 Ill. 150.

[82]Hayward *v.* Leeson (1900) 176 Mass. 310; Yeager *v.* Wallace (1863) 44 Pa. St. 294.

[83]Auten *v.* City Electric Co. (C. C. 1900) 104 Fed. 395.

[84]*Re* Sacker (1888) L. R. 22 Q. B. D. 179.

[85](1872) 16 Wall. 203.

existence of such a statute shows what the law would be in its absence.[86]

The most, it is conceived, that the chancery court, unaided by statute, can do in this sort of case is to exclude the participant in this wrongful transaction from sharing in the distribution of the estate until he has thus been restored to the level of the other creditors. Thus, in *Wilson* v. *Paul*[87] a creditor who had received a part payment by way of a preference was excluded from the distribution until the dividends received by the other creditors reduced their claims proportionately. This measure of relief, however, is so apt to be useless in most cases that it cannot be seriously reckoned with.

If the equity courts could have brought themselves to the point of considering the receiver as clothed with "the rights of a levying creditor" under a judgment in behalf of all the creditors, the result would be different. Then he could attack fraudulent transactions and cases of reputed ownership, as certain courts have held.[88] Preferential transfers, however, would still be immune from active attack, because, as we have seen, such transactions were valid as against judgment creditors.[89] But, laying this limitation aside, it seems sufficient to repeat that the premise of these decisions is wrong. The court cannot give its officer the status of a levying creditor when none of the parties in court, on whose behalf he is to act, have that status. In order to secure equality of distribution there must be such a representative, but it is not within the power of an equity court to create one.

(TO BE CONCLUDED.)

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[86]See Yeager *v.* Wallace (1863) 44 Pa. St. 294; Porter *v.* Williams (1853) 9 N. Y. 142.

[87](1836) 8 Sim. 63.

[88]Duplex Press Co. *v.* Clipper Pub. Co. (1906) 213 Pa. St. 207; H. K. Porter Co. *v.* Boyd (C. C. A. 1909) 171 Fed. 305.

[89]While in some jurisdictions the trust fund theory has been extended so as to forbid preferential transfers by an insolvent corporation, Rouse *v.* Merchants' Bank (1889) 46 Oh. St. 493, the weight of authority is to the contrary. Catlin *v.* Eagle Bank (1826) 6 Conn. 233; Ringo *v.* Biscoe (1853) 13 Ark. *563; Planters' Bank *v.* Whittle (1884) 78 Va. 737; Coats *v.* Donnell (1883) 94 N. Y. 168.